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IN THIS ISSUE:

JDA To Produce Domestic Fighter? 1

Japan, PRC Defense Contacts Resume Pace 2

Japan, Soviets Sign Cultural Accord 4

Falling Oil Prices Affect Japanese Exports To The Middle East 5

Services Trade Spurs Emotional Testimony 6

Tokyo Gives High Cubes Higher Priority 8

The U.S. Trade Deficit: No Light Yet At End Of Tunnel 10

Notes 13

JDA To Produce Domestic Fighter?

A report in the June 6 edition of the Asahi Shimbun suggests that the Japan Defense Agency is leaning toward joint U.S.-Japanese development of a domestically produced aircraft for the FSX program, a new fighter support aircraft intended to replace outdated F-1s and F-4s. Only a few weeks ago, press reports in both countries said that JDA had abandoned hopes for a domestic fighter in favor of co-produced F-18 Hornets, both for political and economic reasons. The possibility had also been raised that an F-18 designed to Japanese specifications -- so-called Super Hornets -- was also in the running, but the latest report suggests that JDA has returned to the domestic option, this

to consider it a conciliatory gesture in that it implicitly suggests that the disputed islands are not in fact part of the Soviet Union.

However, Soviet leader Mikhail Gorbachev made it clear during the Abe visit that the Soviet Union has not altered its view that no issue exists over the northern territories despite Japanese claims to the contrary. Some observers have claimed that this hard line is simply a Soviet ploy to "save face" or maintain negotiating leverage in peace treaty talks. Optimists feel that there is room for an agreement, since Soviet officials keep talking about an issue, although officially they claim there is no issue. At the very least, the current round sustains the momentum established in 1985 toward improved relations -- an important goal for both governments -- and allows both sides to claim victory while seeking further concessions.

Michael W. Chinworth

Falling Oil Prices Affect Japanese Exports To The Middle East

During the first three months of 1986, Japan's imports of oil (crude and partly refined) declined 34 percent in yen terms from the same quarter a year ago, reflecting a drop in both volume and unit price. Volume declined 2.6 percent to 52.5 million kiloliters, while the price dropped to Y31,245 ($184 at Y170=$1.00) per kiloliter, down from Y46,297 ($272) a year earlier. In dollar terms, oil imports fell 12.2 percent to $8.5 billion.

The skid continued in April as oil deliveries fell 20 percent from the same month last year, reaching the third lowest monthly volume in recent years. In addition, there was a noticeable decline in oil purchased from members of the Organization of Petroleum Exporting Countries, whose share of imports fell to 69.8 percent, down from 75.4 percent in March. Shipments from Malaysia and Mexico expanded 24.1 percent and 75.8 percent, respectively, while imports from the United Arab Emirates fell 24.5 percent and Saudi Arabian shipments dropped 53.4 percent. The latter two countries, however, still accounted for almost one-third of Japan's oil imports.

Declining oil prices and the strong yen have contributed to the continued slump in Japanese exports to the Middle East. Shipments, which plummeted from $17.2 billion in 1983 to $12.2 billion in 1985, declined another 4.8 percent in the first quarter of 1986 compared to the year-earlier period (see Table). As a result, the share of Japanese exports going to the Middle East declined from 11.7 percent in 1983 to 5.9 percent. This helped increase Japan's dependence on the U.S. market, which accounted for 36.8 percent of Japanese exports in the first quarter of 1986, up from 29.2 percent in 1983.

Fourteen Middle East countries, including the UAE, Saudi Arabia and Iraq, either peg or closely link their currencies to the U.S. dollar. With its sharp rise against the dollar, the yen has also appreciated against most Middle Eastern currencies. Sales of Japanese cars, for example, normally the market leader in the UAE, dropped 15 to 25 percent during the first four months of 1986. The currency of the UAE, the leading exporter of oil to Japan, has lost one-third of its value against the yen since last September.

Ironically, in light of the controversy in Japan over the summit declaration against terrorism, Libya is a relatively minor trading partner. Japan's exports to Libya fell 39 percent in 1985 to only $253 million, and declined further in the first three months of 1986. Imports of oil from Libya have tapered off sharply since the early 1980s. The low sulphur content of Libyan oil makes it a popular commodity in Europe, but Japan favors less expensive oil from other nations.

Japan's Trade With Middle East Countries

(in millions of dollars)

Country	January-March 1985		January-March 1986	
	Exports	Imports	Exports	Imports
United Arab Emirates	$250	$2,239	$255	$2,532
Saudi Arabia	954	3,387	740	1,956
Iran	282	827	283	751
Iraq	194	88	399	432
Kuwait	379	311	330	500
Oman	157	690	97	605
Qatar	46	477	46	525
Egypt	168	137	164	96
Libya	80	7	61	7
Total*	2,824	8,337	2,689	7,604

*Includes Bahrain, North and South Yemen, Israel, Jordan, Syria, Lebanon, Gaza, Cyprus, Sudan, Ethiopia, Republic of Djibouti and Somalia.

Source: Japan Tariff Association

Randall S. Jones

Services Trade Spurs Emotional Testimony

At the moment, there is little coherence or coordination in the Senate's approach to trade issues. While members of both parties continue to give assurances that there will be a trade bill this year, tax reform fills the hours of the most crucial players -- the members of the Finance Committee. Despite the dramatic passage of the trade reform bill in the House of Representatives, momentum in the Senate has been slow to develop.

Anxious Hill watchers had something to mull over when Sen. Frank Murkowski (R, Alaska) reconvened his series of hearings on U.S.-Japan services trade (see JEI No. 31B, August 14, 1985). Previous sessions focused on trade in transportation services; the June 5 meeting concentrated on construction, engineering and financial services. Particular attention centered on U.S. participation in Japanese public works projects, specifically the planning and construction of the $8 billion Kansai International Airport near Osaka.

high-cube service from the point of departure. In an effort to match this, Japanese firms are purchasing the bigger boxes and upgrading facilities on some routes. In addition, they are seeking links with U.S. railroad companies to provide smooth ship-to-rail service. Although most Japanese shippers consider the adoption of high cubes for domestic use inevitable, they expect the process to take several years as numerous bureaucratic and infrastructural barriers must be overcome.

The convergence of these two factors -- a tougher U.S. stance and pressure from domestic companies -- will undoubtedly encourage Tokyo to loosen high-cube controls at a quicker pace. That pace, however, may not be fast enough for Washington, particularly if Congress focuses more attention on the issue. The Reagan administration may feel pressed enough to include the topic in the new round of market-oriented sector-selective (MOSS) talks.

Jon Choy

The U.S. Trade Deficit: No Light Yet At End Of Tunnel

In the eight months since Washington orchestrated the decline in the dollar's value, Reagan administration economic policymakers and business economists alike have repeatedly tried to dampen expectations of a quick turnaround in the U.S. trade deficit, which ballooned to $148.5 billion (imports c.i.f.) last year. Progress will be painfully slow, they caution, adding that the numbers will get worse before they get better. No one expects the final 1986 red-ink entry to be as huge as the $174 billion indicated by a straight-line projection of the trade gap in the January-March period. But neither do analysts anticipate any improvement in the quarterly figures until mid-year at the earliest.

A look at U.S. trade with Japan in 1986's first quarter highlights why the dollar's fall will not show up any time soon in the overall trade results. On paper the 40 percent-plus drop in the dollar against the yen since late last September has restored the competitive position of American exporters to the pre-1980 level, but in practice the faltering pace of the Japanese economy has neutralized this advantage. Exports, in fact, were off 10.9 percent in the first three months of the year to $5.6 billion as the slower growth of Japanese industrial production trimmed shipments of intermediate inputs and scaled-back investment plans translated into smaller exports of capital goods.

At the same time, the flip-flop in the dollar-yen relationship has not yet proved to be the marketing handicap for Japanese manufacturers that textbooks suggest, simply because big exporters have opted to sacrifice short-term profit margins on U.S. sales to maintain market share. Imports from Japan therefore jumped another 20.2 percent in the January-March 1986 period to $20.9 billion (c.i.f.) on generally higher volume. In the process, the bilateral trade gap, which had climbed to $49.8 billion last year, swelled to $15.3 billion or, simple arithmetic indicates, $60 billion-plus at an annual rate.

Trends in first-quarter trade with Japan, it turns out, merely magnified what was happening elsewhere in the U.S. trade picture. Total exports fell

U.S. Exports to Japan

(in millions of dollars, f.a.s. value basis)

	January-March 1985	January-March 1986	Percent Change
Total Exports	$6,252.3	$5,573.6	-10.9%
Industrial Supplies	2,434.5	2,090.6	-14.1
Bituminous Coal	231.2	158.3	-31.5
Petroleum Products	217.5	189.2	-13.0
Natural Gas	72.4	42.0	-42.0
Nuclear Fuels	42.7	0.1	-99.8
Logs and Lumber	215.2	235.4	9.4
Paper Base Stocks	123.8	118.4	-4.4
Paper and Paper Products	67.6	79.0	16.9
Organic Chemicals	183.2	190.8	4.1
Inorganic Chemicals	256.8	200.9	-21.8
Plastics and Synthetic Resin Compounds	80.1	77.2	-3.6
Fertilizers and Insecticides	90.8	91.7	1.0
Steel Scrap	52.5	63.1	20.2
Nonferrous Ores and Scrap	110.1	134.9	22.5
Nonferrous Metals	91.3	61.7	-32.4
Textiles	31.3	27.0	-13.7
Raw Cotton	183.9	54.3	-70.5
Hides and Skins	69.8	87.3	25.1
Leaf Tobacco	40.0	23.6	-41.0
Capital Goods	1,736.3	1,476.2	-15.0
Nonelectric Machinery	932.7	844.6	-9.4
Data Processing Equipment and Parts	370.4	335.4	-9.4
Measuring, Testing and Control Instruments	136.3	105.5	-22.6
Laboratory Testing and Control Instruments	31.0	28.6	-7.7
Scientific, Professional and Medical Equipment	69.8	77.7	11.3
Oil and Gas Field Equipment	9.3	23.9	157.0
Metalworking Equipment	29.7	39.0	31.3
Service Industry Equipment	30.6	31.8	3.9
Electric Machinery	236.5	224.4	-5.1
Generators and Transformers	20.4	19.2	-5.9
Broadcast and Communications Equipment	102.1	88.7	-13.1
Telephonic and Other Electric Equipment	114.0	116.5	2.2
Transportation Equipment	567.1	407.2	-28.2
Civilian Aircraft	355.8	159.7	-55.1
Civilian Aircraft Engines and Parts	138.4	164.1	18.6
Automotive Parts	44.1	53.5	21.3
Food and Feed	1,213.7	1,238.8	2.1
Corn	371.8	303.0	-18.5
Sorghum	105.4	77.0	-26.9
Soybeans	246.5	248.7	0.9
Wheat	118.1	109.5	-7.3

Fruits and Vegetables	103.8	126.5	21.9
Meat and Meat Products	130.0	172.0	32.2
Fish and Fish Products	52.7	92.1	74.8
Consumer Goods	368.4	385.4	4.6
Pharmaceuticals	155.2	167.5	7.9
Toys and Sporting Goods	23.2	20.5	-11.6
Cigarettes	21.5	26.2	21.9

U.S. Imports from Japan

(in millions of dollars, Customs value basis)

	January-March 1985	January-March 1986	Percent Change
Total Imports	$16,493.4	$19,947.6	20.9%
Automotive Products	5,380.5	7,370.7	37.0
Passenger Cars	3,326.6	4,415.2	32.7
Trucks	983.6	1,463.8	48.8
Automotive Parts	1,068.7	1,486.2	39.1
Capital Goods	5,529.2	6,381.3	15.4
Nonelectric Machinery	3,750.8	4,364.1	16.4
Business Machines	1,748.4	1,990.3	13.8
Metalworking Machinery	292.1	334.4	14.5
Agricultural Machinery	101.5	146.5	44.3
Specialized Industrial Machinery	313.4	370.3	18.2
Scientific, Professional and Medical Equipment	147.7	215.0	45.6
Electric Machinery	1,710.1	1,878.6	9.9
Transportation Equipment	68.3	138.6	102.9
Consumer Goods	3,449.4	3,970.5	15.1
Video and Audio Recorders and Players and Stereo Equipment	1,302.7	1,452.0	11.5
Television Sets	190.8	228.7	19.9
Radio Receivers	82.3	63.1	-23.3
Tableware and Glassware	109.4	119.4	9.1
Metal Cookware and Cutlery	98.0	123.7	26.2
Photographic and Optical Goods	242.8	280.5	15.5
Clocks and Watches	114.6	108.8	-5.1
Toys and Sporting Goods	118.3	130.0	9.9
Motorcycles and Parts	224.1	342.4	52.8
Clothing	132.1	138.3	4.7
Intermediate Goods	1,865.8	1,929.2	3.4
Steel Mill Products	867.6	740.5	-14.6
Nonferrous Metals	126.2	138.2	9.5
Organic Chemicals	151.0	177.9	17.8
Textiles	174.0	223.7	28.6

4.4 percent to $53.7 billion, clipped not only by sluggish growth in Europe and Canada as well as in Japan but also by the continuing debt problems of the Third World and the ongoing decline in revenues earned by oil-exporting countries. On the other side of the ledger, aggregate imports advanced 11 percent to $97.1 billion, in large part because the dollar has held steady or even appreciated against the currencies of five of this country's top ten suppliers -- Canada, which alone accounts for roughly one-fifth of all imports, Mexico, Taiwan, Korea and Hong Kong.

Susan MacKnight

Notes

• On June 4 the Department of Commerce adopted a rule change that would allow the state of Alaska to export crude oil to Japan. The change in the Export Administration Regulations, earlier pledged by President Reagan, allows crude produced from the "state-owned submerged lands" of the Cook Inlet oil fields to be shipped overseas. Since this oil does not pass through or over any federal rights-of-way or pipelines, no amendment to the Export Administration Act, Energy Policy and Conservation Act, or Mineral Lands Leasing Act is necessary. Alaskan officials estimate that production of Cook Inlet wells will average 40,000 barrels a day in 1986, although this is expected to decline by 15 percent per year. Without further development of the inlet's resources, the Commerce Department estimates that no more than 20,000 barrels per day of private petroleum and 4,000 to 5,000 barrels per day of state royalty crude will be available for export.

Tokyo has long been interested in purchasing Alaskan oil but has been blocked by U.S. laws aimed at promoting energy self-sufficiency. The governor of Alaska has also supported sales of crude to Japan as a way to bolster state revenues but has been unable to generate enough interest in Congress to amend the laws. U.S. oil shipping interests have opposed the change, fearing reduced traffic to West and Gulf Coast refineries, and alarmed that the freight business would go to Japanese carriers. Commerce adopted the exemption for Cook Inlet oil partly on the grounds that the quantity was too small to have an impact on American cargo companies. It remains to be seen, however, if Japan will actually sign delivery contracts. With global markets still awash in oil, Japan may not feel pressed to buy the newly freed oil.

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.